STEPHENSON HARWOOD

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Court of Appeal hands down landmark judgment in Property Alliance Group Limited v The Royal Bank of Scotland plc

Overview

On 2 March 2018, the Court of Appeal handed down a landmark judgment in *Property Alliance Group Limited v The Royal Bank of Scotland plc* [2018] EWCA Civ 355.

The decision is likely to have far reaching consequences for claims engaging allegations of LIBOR rigging, or other similar acts of market manipulation, allegations that businesses were inappropriately placed in "turnaround", and mis-selling claims more generally.

Background

From 2003 to 2015 the Royal Bank of Scotland plc ("RBS") was the principal source of funds for Property Alliance Group Limited ("PAG"), a property investment and development business. RBS provided PAG with revolving loan facilities (the "Facilities"), and sold PAG other financial products, including four swaps in October 2004, September 2007, January 2008 and April 2008 (the "Swaps").

Each of the Swaps was stated to supplement, form part of, and be subject to, an ISDA Master Agreement between PAG and RBS (the "Master Agreement"), and was priced by reference to GBP 3 month LIBOR.

In 2010, RBS transferred its relationship with PAG to its turnaround division known as the "Global Restructuring Group" ("GRG"). Thereafter, at PAG's expense, GRG arranged valuations of the properties against which the Facilities were secured (the "Valuations").

On 7 June 2011, PAG terminated the Swaps, incurring a break cost of £8.261 million, and, in September 2013, commenced proceedings against RBS.

PAG's claims

PAG claimed that RBS had:

1. mis-sold the Swaps and made negligent misstatements in relation to them in breach of either: a "*mezzanine duty or intermediate duty*" (a "Mezzanine Duty") as identified in *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043[1]; or the narrower duty identified in *Hedley Byrne & Co Ltd v Heller & Partners Ltd* (1964) AC 465 (HL) (i.e. the duty not carelessly to misstate); which had induced PAG to enter into the Swaps (the "Misstatement Claim")[2];
2. expressly and impliedly misrepresented that: the Swaps would "hedge" PAG's interest rate risk; and that information regarding its own "hedging" in relation to the Facilities would not be withheld from PAG (the "Misrepresentation Claims");
3. transferred PAG to GRG, and managed and retained it in GRG, in breach of implied terms in the Facilities requiring RBS to act in good faith, and exercise its discretion, including in relation to requiring the Valuations, "*reasonably, in a commercially acceptable or rational way, in good faith, for a proper purpose (i.e. the purpose for which such power or discretion was conferred), not capriciously or arbitrarily and not in a way that no reasonable lender, acting reasonably, would do*" in accordance with the requirement identified in *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116 (a "Socimer Requirement") (the "Turnaround Claims"); and / or

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[1] In which the Judge held that, following the judgment in *Bankers Trust International plc v PT Dharmala* [1996] CLC 518, in certain factual circumstances, where a bank provided information regarding products which it wished to sell to a customer, the bank would assume a duty to explain those products accurately, without misleading, including correcting any obvious misunderstandings and answering reasonable questions. However, this duty did not extend as far as a "*duty to educate*" in the sense of giving a comprehensive "*tutorial*", to explain the whole range of products that might be available, or to ensure that the information provided was properly understood by the customer, including in relation to the risks associated with each product offered. The Judge held that a bank would discharge this duty by providing short summaries of the essential attributes of each of the products it had described, provided that the descriptions were not factually wrong or misleading.

[2] It was common ground that RBS did not owe PAG a general duty to advise in relation to the Swaps and that PAG was contractually estopped from bringing such a claim pursuant to the Master Agreement.

4. made implied misrepresentations (the "LIBOR Misrepresentations"[3]) regarding the Swaps by proposing and entering into them (the "LIBOR Claim").

All of PAG's claims were dismissed at first instance by Asplin J and PAG appealed certain of her findings.

The Court of Appeal's Decision

The Misstatement Claim

The Court of Appeal agreed with the Judge that RBS was not in breach of a *Hedley Byrne* duty, emphasising that, amongst other things: "*PAG was made fully aware that (1) breaking any of the Swaps could carry adverse financial consequences, (2) the size of those financial consequences would depend upon interest rates at the time the Swaps were broken, and (3) the precise calculation of any amount to be paid by PAG would take into account the extent to which, if at all, the floating-rate payable by RBS under the Swaps was lower than the fixed interest payable by PAG*".

The Court of Appeal also upheld the Judge's finding that RBS did not owe PAG a wider duty of care to disclose its own internal credit line calculations or break cost scenarios, as, amongst other things:

1 it was not normal practice for banks to disclose those calculations;

2 PAG could have prepared its own calculations;

3 PAG represented in the Master Agreement that it understood and accepted the risks of the transactions and was capable of assuming, and assumed, those risks, and this representation was repeated on a number of occasions thereafter; and

4 in any event, PAG did not enter into the Swaps because of RBS' failure to disclose its internal calculations (which PAG had not, in fact, requested from RBS).

The Court of Appeal dismissed the existence of a Mezzanine Duty save in exceptional circumstances, concurring with the Judge's view, and that of Mr Murray Rosen QC, sitting as a deputy High Court judge, in *Marz Limited v Bank of Scotland plc* [2017] EWHC 3618 (Ch) and Rose J in *London Executive Aviation v The Royal Bank of Scotland plc* [2018] EWHC 74 (Ch) where the existence of a Mezzanine Duty which arose automatically upon a lender providing information in relation to a financial product was expressly doubted.

The Misrepresentation Claim

The Court of Appeal upheld the Judge's finding that a reasonable representee would not have understood representations in relation to the Swaps in the manner which PAG had contended (i.e. that the Swaps would completely "hedge" PAG's interest rate risk) and that in any event, PAG had not entered into the Swaps in reliance on the representations which it contended had been made.

LIBOR Claim

The Court of Appeal found that although RBS had not made the LIBOR Misrepresentations alleged by PAG, it had impliedly represented that it "*was not manipulating and did not intend to manipulate*" GBP LIBOR. However, PAG's appeal failed on the facts as the Court of Appeal upheld the Judge's finding that RBS had not been demonstrated to have actually been manipulating GBP LIBOR.

The Court of Appeal notably left open critical issues arising from this finding, such as the approach to be adopted in relation to reliance where implied representations are held to have been made.

The Turnaround Claims

The Court of Appeal overturned the Judge's finding that RBS' right to require Valuations was unfettered, holding that it was subject to a requirement that it must not be exercised "*for a purpose unrelated to [RBS'] legitimate commercial interest or if doing so could not rationally be thought to advance them*". However, the Court of Appeal held, on the facts, that PAG had failed to show that the 2013 Valuation was commissioned in breach of this requirement.

[3] These representations are set out at paragraph 375 of Asplin J's judgment (*Property Alliance Group Limited v The Royal Bank of Scotland plc* [2016] EWHC 3342 (Ch)).

Practical implications of the Court of Appeal's decision

The Court of Appeal's judgment has various practical implications, including, but not limited to, the following.

Mezzanine Duty

It is no longer arguable that a Mezzanine Duty arises merely because information has been volunteered by a vendor in relation to a financial product. The Court of Appeal's judgment makes it clear that the ambit of a vendor's duty is highly fact sensitive and will depend on, amongst other things, the information proffered by the vendor, the sophistication of the customer, the context in which the financial product is being purchased, the customer's enquiries made in relation to the financial product, and the relevant contractual documentation (see *Marz* and *London Executive Aviation Limited* for examples of how the Court will approach such an analysis).

LIBOR rigging claims

The finding that RBS made an implied representation that it would not engage in manipulating GBP LIBOR opens the door to potential claims in appropriate factual circumstances (e.g. where it can be demonstrated that a lender was engaged in the manipulation of the relevant measure (e.g. LIBOR rates, FOREX rates etc.) by reference to which the relevant product was priced (e.g. GBP LIBOR)). However, it remains uncertain whether such claims would, in fact, succeed if it can be demonstrated that such an implied representation was made, and, if so, the remedies which would be available, given the Court of Appeal's failure to provide guidance on the availability of claims in fraudulent misrepresentation and on reliance.

Turnaround claims

The finding that RBS' contractual discretion to seek valuations of the Secured Properties was, in fact, fettered, will potentially open the door to claims for breach of contract where it is arguable that a lender sought a valuation for an improper purpose. Furthermore, going forward, where lenders are exercising their discretion to seek valuations, they will need to ensure that they are, in fact, doing so for a purpose related to their legitimate commercial interest.

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